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IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

JOSEPH T. LYKES,
Petitioner

vs.

UNITED STATES OF AMERICA
Respondent

(1) PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

(2) MOTION TO DISPENSE WITH THE PRINTING OF THOSE PORTIONS OF THE RECORD TRANSMITTED IN THE ORIGINAL BY THE DISTRICT COURT TO THE COURT OF APPEALS WHICH WERE NOT PRINTED IN THE COURT OF APPEALS.

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Respondent

(1) PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The Petitioner prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Fifth Circuit entered in the above entitled cause on April 27, 1951 (R 59), reversing a decision and judgment of the United States District Court for the Southern District of Florida (R 44). That decision and judgment directed that the plaintiff should recover for overpayment of certain income taxes, as a result of the plaintiff's right to deduct certain legal expenses paid in connection with a disputed liability for a gift tax deficiency, that right to deduct having been in the taxpayer by virtue of Section 23 (a) (2) of the Internal Revenue Code.

JURISDICTION

The judgment of the Court of Appeals was entered April 27, 1951 (R 59).

The jurisdiction of this Court is invoked under Section 1254 (1) of the Judicial Code, being 28 U S C Section 1254 (1).

OPINIONS BELOW

The Memorandum Opinion of the District Judge, Southern District of Florida, is recorded at 84 F Supp 537.

The opinion of the Court of Appeals is not yet reported.

QUESTIONS PRESENTED

The petitioner contends that the Court of Appeals erred in its apparent determination that any litigation related to gift taxes necessarily means that the expenses of that litigation are not deductible under Section 23 (a) (2) of the Internal Revenue Code. The question, therefore, is: Was the District Court correct in determining that under some circumstances litigation expenses involving gift taxes *are* deductible from income as non-trade or non-business expenses incurred in the "management, conservation, or maintenance of property held for the production of income;" and that such expenses were properly deductible under the facts and circumstances of the instant case?

The Petitioner contends that the District Court's determination was proper, and that the question should be answered in the affirmative.

Perhaps more important to the question of granting certiorari is the question of whether the District Court could properly be reversed by the Court of Appeals in this case, which involves principally, according to the decisions of this Court *(Bingham's Trust vs. Commissioner of Internal Revenue,* 325 U S 365, 370; 89 L ed at 1675), questions of fact.

The Petitioner contends that the Court of Appeals could not within the proper scope of its power of review, reverse the District Court on the record in this case.

STATUTE AND REGULATIONS INVOLVED

The statute involved is Section 23 of the Internal Revenue Code (26 U S C Section 23) as amended by Section 127 (a) of the Revenue Act of 1942, c 619, 56 Stat 798. This Statute reads in part as follows:

"Section 23. Deductions From Gross Income

"In computing net income there shall be allowed as deductions:

"(a) Expenses.—

"(2) Non-Trade or Non-Business Expenses.—

"In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

The Regulations of the Treasury Department here involved (Regulations 111, Section 29.23 (a) -15) have been set out as Appendix B of this Petition.

STATEMENT OF THE CASE

This case was tried in the District Court partly on stipulated facts, and on undisputed testimony and exhibits (R 18-43). On June 8, 1949, the District Judge filed a Memorandum Decision (R 44-49), in lieu of findings of fact and conclusions of law, which decision ordered that judgment be entered in favor of the taxpayer. Judgment was so entered on order of the Court as of November 14, 1949 and filed the following day.

The record, therefore, presents a clear-cut issue as to whether a District Court could find as a fact that litigation expenses which were related to gift tax liabilities could be incurred, either for the production or collection of income, or for "management, conservation or maintenance of property held for the production of income"; and whether there were sufficient facts in this case to support the finding of the District Judge. And it presents the further question of the scope of review by the Court of Appeals of questions of fact found in the decision of a District Judge.

We do not believe that an extended statement of the facts is necessary, inasmuch as the following facts pertinently demonstrate that this case is distinguishable from the ordinary run of cases involving purely personal gifts; and that consequently there was adequate warrant for the District Court's determination that the litigation expenses involved were not proximately caused by a purely personal transaction.

(1) On March 3, 1944, the Commissioner of Internal Revenue notified the Petitioner that a determination of his gift tax liability for 1940 disclosed a deficiency of $145,276.50 (R 45):

(2) The Petitioner-taxpayer engaged K. I. McKay to represent him and to file a petition in the Tax Court for redetermination of such deficiency (R 45). In 1944, the year of the determination of the deficiency, the petitioner paid his attorney $7,263.83 for such legal services (R 46).

(3) Two years later a compromise settlement was reached in the Tax Court case, without trial, on a stipulated gift tax deficiency of $15,612.75, as compared with the $145,276.50 asserted (R 45-46) (R 20-21).

(4) Among the facts and circumstances of the original gifts by this petitioner were the following:

(a) Gifts were made in 1940 of 1000 shares of stock of Lykes Brothers, Inc., a closely held corporation, out of total holdings of the petitioner of approximately 3000 shares (R 36; 44), 250 shares each to his wife, his son and each of his two daughters.

(b) In addition to the motive of love for the gifts, there were additional motives, principally to insure a continuity of ownership and management of the company in accordance with a custom pursued by other members of the Lykes family (R 45); and thus to further fortify the retained interests in the company (R 32). This policy has produced results (R 33, 34, 35, 36).

(c) A substantial interest in Lykes Brothers, Inc., had been retained by the Petitioner through the time of the trial (R 37).

(5) The District Court presumably found in favor of the following contentions of the Petitioner:

(a) Had the asserted gift tax deficiency been successfully enforced against the petitioner it would have substantially destroyed his holdings in Lykes Brothers, Inc., and would have confiscated most of the property held by him for the production of income (R 46).

(b) The payment of attorney's fees of $7,263.83 was made, not as the result of an ordinary contest concerning the valuation of ordinary personal gifts, but it was a payment of legal expenses incurred to forestall the collection by the Government of an assessment of a tax which was so clearly arbitrary and capricious that in fact, it had nothing to do with the gift on which it was based (R 46).

No questions were raised concerning the payment of the tax sought to be refunded. If the payment for the legal services to K. I. McKay is deductible from gross income for the year, as the petitioner claims, then the petitioner is entitled to recover $5,665.78, together with interest, from the respondent (R 45-46).

DECISIONS OF THE DISTRICT COURT AND OF THE COURT OF APPEALS

The District Court found for the petitioner, substantially relying on the facts referred to in the summary above (Memorandum Decision, R 44-49). The District Court also found that the Regulations (Treasury Regulation 111, Section 29.23 (a)-15) insofar as they attempted to prohibit the deduction, were in conflict with the Statute and not effective. In finding for the petitioner the District Court necessarily found as a fact that the litigation expenses paid by the petitioner were "ordinary and necessary expenses paid or incurred during the taxable year for the protection or collection of income, or for the management, conservation

or maintenance of property held for the production of income." The District Court also refused to follow a Sixth Circuit case, *Cobb vs. Commissioner,* 173 F 2d 711, in which certiorari was denied by this Court (338 U S 832, 338 U S 882).

The Court of Appeals for the Fifth Circuit in its decision (R 59-65) determined that Treasury Regulation 111, Section 29.23 (a) -15 (b), was not in conflict with the Statute, but was a reasonable and consistent interpretation thereof, was valid and controlling in this case, and denied the deduction claimed by the petitioner (R 64).

CLAIM BY THE PETITIONER

It is the petitioner's principal claim that the Court of Appeals, in reversing the decision of the District Court, improperly ignored the holding of the Supreme Court of the United States in the case of *Bingham's Trust vs. Commissioner,* 325 U S 365, 89 L ed 1670, to the effect that the lower court's determination of whether or not a particular expense met the conditions of the statutory deduction was principally a question of fact, and that the trier of the fact in this case found for the petitioner *(Bingham case,* 325 U S, 371, 373, 376).

It is also the claim of the petitioner that the decision of the Court of Appeals conflicted in principal with *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 U S 365, 89 L ed 1670, and other cases in this Court there cited.

REASONS FOR GRANTING THE PETITION

The Court of Appeals for the Fifth Circuit has decided an important question of Federal law in a manner which conflicts with a decision of this Court on the same subject.

The application of Section 23 (a) (2) of the Internal Revenue Code is a very important part of federal tax law. It is a broad relief statute, and had as one of the reasons for its approval by Congress, a consideration that the decisions of this Court were very strict interpretations of the business expense section of the same statute *(Nahstoll, I R C Section 23 (a) (2)*, 46 Michigan Law Review 1015, 1016). The Regulations issued by the Treasury Department in interpretation of that statute are presently some fifteen paragraphs in length. Amendment of those Regulations has been forced by other decisions of this Court (T D 5513, May 14, 1946, 1946 *Internal Revenue Bulletin*, page 61).

It is important that this statute and the regulations issued hereunder receive interpretation by this Court, which will adequately guide the courts trying the facts to a determination of their functions under that Statute, and restrict the activities of the Court of Appeals to reversals for obvious errors of law. If this matter is not so determined, then each decision in the courts which are trying the facts will automatically be reversible, as a *de novo* adjudication, in the Court of Appeals, thereby disrupting the business of the Courts and unduly increasing the cost to taxpayers of litigation with their Government.

Furthermore, this case involves, in principle, determinations made by this Court in *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 U S 365, and the decision of the Court of Appeals is, in the Petitioner's opinion, contrary to the principles of that case.

A memorandum brief in support of the taxpayer's position is appended hereto as Appendix A.

CONCLUSION

It is respectfully submitted that this petition for certiorari to review the judgment of the Court of Appeals of the Fifth Circuit should be granted.

Respectfully submitted,

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Dated June 29, 1951.

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MOTION TO DISPENSE WITH THE PRINTING OF THOSE PORTIONS OF THE RECORD TRANSMITTED IN THE ORIGINAL BY THE DISTRICT COURT TO THE COURT OF APPEALS WHICH WERE NOT PRINTED IN THE COURT OF APPEALS.

1. Your Petitioner respectfully moves that the Court enter an order dispensing with the printing of those portions of the Record transmitted in the original by the District Court to the Court of Appeals, namely Plaintiff's Exhibits 1 through 8, and as reason therefor makes the following statements.

2. On motion of the United States, to which the Petitioner herein waived objection, the District Court ordered that the Plaintiff's Exhibits 1 through 8, should be transmitted by the Clerk of the District Court to the Court of Appeals in lieu of having same printed as a part of the record (R 54-56).

3. Plaintiff's Exhibits 1 through 8 are principally mathematical calculations of tax and documents supporting the refund claim for the purpose of demonstrating that the Petitioner's suit in the District Court was within the basic framework of the claim filed. In the opinion of the Petitioner, they are not important to the issues brought before this Court.

DATED June 29, 1951.

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APPENDIX A

MEMORANDUM BRIEF IN SUPPORT OF PETITION

OUTLINE OF ARGUMENT

I. The Court of Appeals should have considered the District Court's determination as essentially one of fact, and so should have refused to reverse that determination.

1. The applicability of Section 23 (a) (2) is essentially a question of fact.

Bingham's Trust v. Commissioner of Internal Revenue, 325 US 365, 371, 373, 376; 89 L ed 1670.

2. Determinations of fact made by the District Court must be clearly erroneous to be reversed by the Court of Appeals.

Federal Rules of Civil Procedure, Rule 52.

United States v. Yellow Cab Co., 338 US 338, 94 L ed 150.

United States v. Cummin's Distillers Corporation, 166 F 2d 17 (CCA, 6, 1948)

Lowden v. Hanson, 134 F 2d 348 (CCA, 8, 1943).

a. The effect of memorandum decisions is the same as findings of facts and conclusions of law.

Federal Rules of Civil Procedure, Rule 52.

b. In cases where memorandum decisions fail to make sufficient findings, the Court of Appeals either cannot act or must remand.

Mayo v. Lakeland Highlands Canning Co., 309 US, 310, 319; 84 L ed 774, 780.

Massachusetts Bonding & Ins. Co. v. Preferred Automobile Ins. Co.; 110 F 2d 764 (CCA, 8, 1940)

Webster-Brinkley Co. v. Belfield, 166 F 2d 814 (CCA, 9, 1948)

Public Service Commission v. Wisconsin Telephone Co., 289 US 68, 71; 77 L ed 1036, 1038.

3. The Court of Appeals erroneously considered, (a) that the prohibition of the Regulations was absolute rather than exemplary; and (b) that the expense incurred in the instant case was within the prohibition as a matter of law.

a. The Regulations are in terms only exemplary. Regulations 111, Section 29.23 (a)-15.

b. A Regulation with a prohibition as broad as that contended by the Court of Appeals would conflict with the meaning and purpose of Section 23 (a) (2) and so be unauthorized.

c. The Treasury Department cannot by means of Regulations change an essentially factual determination into a legal conclusion.

Miller v. United States, 294 US 435, 439-440; 79 L ed 977; 980-981.

Waite v. Macy, 246 US 606, 609; 62 L ed 892, 895.

Busey v. Deshler Hotel Co., 130 F 2d 187, 142 ALR 563.

4. Conclusion: The District Court made a proper factual determination which should not be upset by the Court of Appeals. In the event that there is any possible factual basis on which the District Court might have found for the Plaintiff, the case should have been remanded by the Court of Appeals for additional findings of fact and conclusions of law, before a final determination by the Court of Appeals.

I. There is no distinction in principal between the case of *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 US 365; 89 L ed 1670, and the instant case.

1. There is no distinction in the application of Section 23 (a) (2) to a trust rather than to an individual.

2. Section 23 (a) (2) treats the individual in the management of his income producing property as a business entity.

3. The distribution of an individual's income producing property is a necessary corollary of his having such property.

a. It should make no difference to the taxability of expenses in the handling of income producing property that an individual chooses to make direct distribution of such property by inter vivos gifts, rather than by the more cumbersome means of testamentary distribution and trusts utilized in the *Bingham* case.

ARGUMENT

I.

The application of Section 23 (a) (2) to a particular factual situation was determined by this Court in *Bingham's Trust v. Commissioner of Internal Revenue*, 325 US 365, 89 L ed 1670, to be essentially a question of fact, on which the determination of the trial court should not be reversed unless clearly erroneous.

> "Ordinary questions of reasonableness and proximity are for the trier of fact, here the Tax Court." (325 US at 370)

> "To exclude from the deduction privilege, expenses which the Tax Court has held to be expenses of management of the trust, on the ground that the trust fund, upon the expiration of the trust, ceased to be 'held for the production of the income' would be *to disregard the Tax Court's findings of fact* and the words of the statute, and would defeat its obvious purpose." (325 US at 373, emphasis supplied)

> "The Tax Court could find as a matter of fact, as it did, that the expenses of contesting the income taxes were a proximate result of the holding of the property for income." (325 US at 376)

It is clear that the Court of Appeals in the instant case reversed the District Court principally on the question of proximity, holding that such expenses were "indirectly, not proximately, related to the management and conservation of the taxpayer's income producing property." (R 64) The Court of Appeals' reliance on the Regulations will be considered briefly later. At this point we consider that it is clear that:

(1) A result may be *indirect*, but nevertheless *proximate*. *Aetna Insurance Co. vs. Boon*, 95 US 117, 130; 24 L ed 395, 399.
Miles vs. Van Hagen, 128 P 2d, 89, 92, District Court of Appeals, Second District, California 1942.
It is sufficient if the expense "is directly connected with *or* proximately results from the conduct of the business" (*Bingham case*, 325 US at 374 emphasis supplied; *Appeal of Backer*, 1 BTA 214, 216, cited *Kornhauser v. United States*, 276 US 145, 153, 72 L ed 505, 506) or from the management or conservation of property held for the production of income.

(2) The determination of the proximate relationship between the expense and the management or conservation of the income producing property is one of fact.

Such determinations of fact must be clearly erroneous in order that the Court of Appeals may reverse. *Federal Rules of Civil Procedure, Rule 52.*

This rule applies to appeals by the Government; and its purpose is to avoid trials *de novo* in the appellate courts. *United States v. Yellow Cab Co.*, 338 US 338, 94 L ed 150.

In the instant case, the District Court did not make specific findings of fact, but wrote a Memorandum Decision ordering judgment for the plaintiff (R 44-49). Such memorandum decisions are "sufficient if the findings of fact and conclusions of law appear therein" *Federal Rules of Civil Procedure, Rule 52.* The Court of Appeals did not consider the District Court's findings, and, in effect, made findings of its own. We cannot,

therefore, determine whether the Court of Appeals found the District Court's findings adequate. If they were not, then the Court of Appeals either: (1) cannot act, because of a failure to present a reviewable question for determination (*Massachusetts Bonding & Ins. Co. v. Preferred Automobile Ins. Co.*, 110 F 2d 764—CCA, 8, 1940), or (2) must remand, so that "any action taken by the Court shall be upon findings of fact and conclusions founded upon the evidence, in accordance with Rule 52 (a) of The Rules of Civil Procedure". *Mayo v. Lakeland Highlands Canning Co.*, 309 US 310, 319, 84 L ed 774, 780; also, *Webster-Brinkley Co. v. Belfield*, 166 F 2d 814 (CCA, 9, 1948); *Public Service Commission v. Wisconsin Telephone Co.*, 289 US 68, 71; 77 L ed 1036, 1038.

Under that rule, which applies as well to inferences from undisputed testimony as to determinations of conflicting evidence (*Lowden v. Hanson*, 134 F. 2d 348, 351—CCA, 8, 1943), it would appear that the Court of Appeals should have either dismissed the appeal or remanded, particularly as its own findings of fact are, in at least one instance, at variance with the record:

Opinion (R 60): "The three children were unmarried and lived with plaintiff. Previous to the gifts, they had taken no active interest in the management of the corporation's affairs. Whether they did so thereafter, does not appear."

Testimony (R 34-35):

"Q. Take your own son, for instance, Joseph T. Lykes, Jr., to whom you made gifts in 1940, did he follow what you thought he would and become identified with the Company?

A He has been, since his release from the Navy, actively identified in the business, and has taken increased responsibility, and functioning as I had hoped he would.

Q Does he also have any official connection with any of the business?

A He is a Director today of both the parent company and the Steamship Company."

This testimony is on the important point of the non-personal aspect of the gift.

We contend that there are *several* bases in the evidence for support of the ultimate fact that the expense in question was proximately related to the management or conservation of income producing property, including: (1) The non-personal aspects of this particular gift, (2) the arbitrary and capricious act of a government agent as an efficient intervening cause between the gift and the legal expenses, (3) the payment of the legal fees, *not* for the successful conclusion of the gift tax case, which occurred two years later, but at the time of the deficiency assertion and for relief against the immediate collection of the tax, and (4) the effect of that arbitrary and capricious act on the income producing property given and on that retained. In order to hold as it did, the Court of Appeals must have decided, contrary to the *Bingham* case, that the proximate relationship between the legal expenses and the management or conservation of income producing property is, in cases involving gifts, a matter of law. The *Bingham* case makes no such exception, and we consider it unwarranted under the statute, the regulations, and the decisions of this Court.

The Court of Appeals considered the regulation interpreting Section 23 (a) (2) as having the force and effect of law. This is so to the extent that the regulation properly *interprets* the law. The first two paragraphs of Regulation 111, Section 29.23 (a)-15 (b) *are* principally interpretive; the rest of the paragraphs of that subsection are principally composed of cited examples of allowed and disallowed deductions, which is particularly true of the phrase relied on by the Court of Appeals (R 62, Note 1, italicized phrase):

> It is settled law in this Court that, while certain examples may be used as guides in interpreting legislation, they cannot be considered as absolute determinations of factual situations, foreclosing a true judicial determination of whether the facts in a particular case do or do not meet the statutory requirement.

> "Undoubtedly, the regulation in terms declares that permanent loss of the use of one hand and one eye shall be deemed to be total permanent disability under an insurance policy such as that issued to petitioner. But the regulation is both inapplicable and invalid.

> * * *

> "It is invalid because not within the authority conferred by the statute . . . It is not, in the sense of the statute, a regulation at all, but legislation. * * * The vice of the regulation, therefore, is that it assumes to convert what in the view of the statute is a question of fact requiring proof into a conclusive presumption which dispenses with proof and precludes dispute. This is beyond administrative power." *Miller v. United States*, 294 US 435, 439-440, 79 L ed 977, 980-981.

To the same effect, *Waite v. Macy*, 246 US 606, 609; 62 L ed 892, 895; and also *Busey v. Deshler Hotel Co.*, 130 F 2d 187, 190; 142 ALR 563.

Conclusion: We respectfully contend that the District Court made a proper factual determination which should not be upset by the Court of Appeals. In the event that there is any possible factual basis on which the District Court might have found for the Plaintiff, the case should have been remanded by the Court of Appeals for additional findings of fact and conclusions of law, before a final determination by the Court of Appeals. The Regulations cannot excuse the abdication by the Courts of appropriate judicial functions. The finding of facts is such a function, and appropriately one for the trial court alone. We should not, as suggested by the alternative views of the Court of Appeals decision, condone either the abdication of that judicial function, nor the undue prolongation of litigation by the equal participation therein of the Court of Appeals.

II

The principles of the *Bingham* case, 325 US 365; 89 L ed 1670, should determine the result in this case. Those principles are antithetical to the Regulations as stringently interpreted by the Court of Appeals.

There is no distinction in Section 23 (a) (2) between its application to a *trust* and to an *individual*. It is in terms applicable to an individual, and only by virtue of Sections 161 and 162 of the Code is it applicable to a trust (*Mary Lily Bingham Trust*, 2 TC 858). Thus, whatever this Court in the *Bingham* case said of the management of a trust is also true of the management of an individual's income-producing fund of property—frequently referred to in ordinary parlance as his "estate."

Consequently, when this Court determines that "Section 23 (a) (2) thus treats the *trust* as an entity

for producing income comparable to a business enterprise" (325 US at 374), it also determines that the *individual's* income-producing "estate" is a comparable entity.

Furthermore, if expenses in connection with the distribution of the trust corpus are deductible as expenses of the management of that income-producing property (325 US at 374, 375), so are expenses in connection with the distribution of the individual's income-producing "estate," regardless of whether he utilizes the mechanism of a trust to that purpose or the simpler mechanism of an inter vivos gift.

Under today's tax laws, the distribution of an individual's income-producing property is often a necessary function of his having such property. He can't take it with him; and inter vivos transfers are a recognized means of conserving the owner's total property. (For example, pages 136 through 151 of Trachtman's *Estate Planning,* 1949 edition, Practicing Law Institute, discuss inter vivos transfers.) The very property which was dealt with in the *Bingham* case was merely the subject matter of the ultimate distribution of an individual's income producing estate. The use of that more cumbersome method of distribution is not a distinction which can logically differentiate it from the instant case.

Conclusion: We respectfully contend that the basic principles applicable to the *Bingham* case should be applied in the instant one, and that, insofar as the present Regulations are inconsistent with that application of those principles, they should be held to be unauthorized.

APPENDIX B

TREASURY REGULATIONS 111

Section 29.23 (a)-15.

Nontrade or Nonbusiness Expenses.—(a) In general.

Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a) (2) only upon the condition that;

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) It is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation or maintenance of a building de-

voted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23(a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. Section 24 (a) (5) disallows any amount other-

wise allowable as a deduction (whether under section 23 (a) (2) or otherwise) which is allocable to one or more classes of tax-exempt income, other than interest, and has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts otherwise allowable under that section which are allocable to tax-exempt interest. Thus, any amount allocable to the production or collection of one or more classes of income which is not includible in gross income or to the management, conservation, or maintenance of property held for the production of such income is not deductible under section 28 (a) (2). Nor does section 23 (a) (2) allow any expenses which are disallowed by any of the provisions of chapter 1.

Capital expenditures and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

Among expenditures not allowable under section 23 (a) (2) are the following: Commuters' expenses;

expenses of taking special courses or training; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; and expenses such as expenses in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, campaign expenses of a candidate for public office, bar examination fees and other expenses incurred in securing admission to the bar, and corresponding fees and expenses incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23 (a) (2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer of such investment.

Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.

Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration

expenses, including fiduciaries' fees, and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under this section, notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of tax-exempt income. But see section 29.162-1 for disallowance of such deductions to an estate where such items are claimed as a deduction under section 812 (b) in computing the net estate subject to the estate tax.

Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property held for the production of income, belonging to the ward or minor are deductible.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deducible expenses. Expenses paid or incurred by an individual in the determination of liabil-

ity for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7). Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow expenses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other

section of the Internal Revenue Code or the regulations applicable thereto. Double deductions are not permitted. Amounts deducted under one provision of the Code cannot again be deducted under any other provision thereof. (Amended by T.D. 5331, approved Feb. 9, 1944, and by T.D. 5513, approved May 14, 1946.)